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SUBJECT: GOB BUDGET: THE GOOD, THE BAD AND THE UGLY

SUMMARY

1. (SBU) The recently-passed Government of Bangladesh (GOB) budget is expansionary and flexible. The \$16.6 billion budget includes a progressive initiative for encouraging public-private partnerships to develop energy and transport infrastructure. More troubling is a tax amnesty that would allow Bangladeshis to "whiten" so-called "black money." Local economists also voiced concern about increased duties on a range of imports, which they characterized as unduly protectionist.

EMPHASIS ON FISCAL STIMULUS

2. (SBU) Bangladesh's FY10 budget reflects many of the priorities the Awami League outlined in its election manifesto, including increased spending on employment, education and health programs; expanding the social safety net, especially food subsidies; and investing in infrastructure. The Government of Bangladesh (GOB) traditionally allocates many of these expenditures under its "Annual Development Program," or ADP. The GOB almost always fails to fully implement the ADP during the fiscal year, which runs from July 1 to June 30.

3. (SBU) This year's ADP totals \$4.4 billion, which, according to a local think tank, is 19 percent higher than the proposed ADP for FY09 and 33 percent higher than the amount of last year's ADP the GOB actually implemented. As the think tank reported, the new ADP was "not oversized in the context of the country's needs, but ambitious in the context of current implementation capacity."

4. (SBU) A World Bank economist characterized the budget as "expansionary," which was not necessarily bad given the current global economic situation. The fiscal stimulus, social safety net programs and large ADP allocation in the budget would give the GOB flexibility to offset potential slowdowns in Bangladeshi exports and remittances, key drivers of Bangladesh's economy and the areas most likely to be affected by the global economic crisis. (NOTE: Bangladesh's exports and remittances both grew during FY09, which ended on June 30. Exports grew 13 percent, and remittances grew 23 percent. END NOTE.)

5. (SBU) This expansion was good, the economist added, only so long as it funded real investment in infrastructure, education, health, etc. An expansionary budget was worthless if politicians and

middlemen siphoned funds from investment and development projects.

PUBLIC-PRIVATE PARTNERSHIPS

¶16. (SBU) One of the most promising new initiatives of the budget is one that promotes public-private partnerships to develop transport and energy infrastructure in Bangladesh. The GOB allocated more than \$300 million to get this initiative off the ground, including funds for technical assistance to ensure proper implementation of the program. The PPP initiative, as it is known, was apparently the brainchild of a small group of young businessmen and respected economists, who wrote a position paper for the GOB that formed the core of the proposal.

¶17. (SBU) Critics have warned that the PPP initiative could just become another avenue for graft if the government did not implement it properly. The GOB's announcement that the first PPP project would be a light rail system for Dhaka drew criticism from some experts who said this project was overly ambitious and the GOB should focus on smaller projects at first, including independent power plants. Others have praised the proposal. At a follow-up seminar with GOB officials and businessmen, officials from India who implemented a similar program briefed the Bangladeshis on public-private partnership best practices from the Indian experience.

"MONEY WHITENING"

¶18. (SBU) The most controversial component of the budget is a tax amnesty that will allow Bangladeshi citizens and companies to

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legitimize previously undisclosed income. As originally proposed, the amnesty, or "whitening of black money," would allow taxpayers to pay only 10 percent in taxes on previously undisclosed income declared sometime before 2012, as long as taxpayers invested the money in a variety of sectors, including real estate. The original proposal also stated taxpayers would not have to disclose the sources of their income, which left the door open for the legalized laundering of the proceeds of crime and terrorism.

¶19. (SBU) Critics attacked almost every aspect of the proposed amnesty. The Ambassador, joined by the chiefs of the European Union, British, Australian, Canadian, German, Dutch and Danish missions, wrote the Finance Minister to express serious concern that the failure to disclose sources of income violated not only Bangladesh's own Anti-Money Laundering (AML) and Anti-Terrorism laws, but also international standards laid down by the Financial Action Task Force (FATF).

¶110. (SBU) Economists said the proposal could destroy the GOB's ability to collect taxes, which was not very strong in the first place. Who would pay the normal 25-45 percent tax rates when they could get away with paying only 10 percent at the end of three years? GOB officials weakly responded that the amnesty was a political necessity, which would increase investment in Bangladesh. Local businessmen said the amnesty was simply a ploy for politicians to legalize the proceeds of graft and extortion. The World Bank noted that various Bangladesh governments had implemented tax amnesties nine times since the 1980s. All these amnesties combined recovered less than \$3 billion in previously undisclosed income and taxes.

¶111. (SBU) In the face of this criticism, the GOB amended the amnesty to cover only one year. The GOB adjusted the wording of the final legislation with the intention of insuring the legislation did not over-ride AML and anti-terrorist finance laws. The central bank also pledged to issue regulations confirming this and directing banks to continue exercising due diligence and verifying sources of funds.

PROTECTION FOR LOCAL INDUSTRY

¶12. (SBU) Local economists also criticized the range of customs, supplementary and regulatory duties the budget placed on a variety of imports, including cars, mobile phones, powdered milk, snack foods, newsprint, air-conditioners and other consumer goods. An economist and banker said these duties punished consumers. An international economist noted these duties protected local industries that already received high rates of protection. These criticisms prompted the GOB to adjust some of the tariffs in its final legislation, including on some cars, newsprint and mobile phones.

PAYING FOR THE BUDGET

¶13. (SBU) The GOB projected a budget deficit of about \$5 billion, or roughly 5 percent of GDP. Some local experts questioned the GOB's revenue estimates for the coming year and expressed doubt about the government's abilities to increase tax collection, particularly as a result of the tax amnesty provisions. Assuming the deficit projection remains on target, the GOB planned to finance 60 percent of the deficit from domestic sources, mostly through local bank borrowing. Some experts cautioned this could crowd out private sector borrowing, while others claimed local banks had excess liquidity that could absorb government borrowing. In terms of foreign financing of the deficit, an economist at one multi-lateral lending institution was pessimistic about the prospects for budgetary support from his organization. He said some of the budget's protectionist measures and the GOB's stated intentions to slow divestment of state-owned enterprises and revamp its public procurement rules could harm prospects for foreign budget support.

COMMENT

¶14. (SBU) With the exception of the tax amnesty and some of the

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tariff increases, the GOB budget is largely sound. It contains some buffers that could allow the government to compensate for unexpected shocks. It seeks to fulfill some of the Awami League's promises to aid the poor and promote growth in the face of a global economic slowdown. The GOB has projected its economy will grow 5.5 percent in the coming year, which some say is too modest a projection. Modest it may be, but it is also politically savvy. It dampens expectations for a year where Bangladesh might finally feel the effects of the global economic crisis. And if growth exceeds the projection, the government can claim the credit.

¶15. (SBU) The devil, as always, is in the details. In its first six months, the Awami League government has not demonstrated an ability to move quickly on key economic goals, particularly energy and power development. Bureaucratic inertia is partly to blame, but dividing the spoils after eight years out of power has distracted many in the Awami League from pursuing national economic priorities. It remains to be seen whether the Awami League can and will direct its energies to achieving its numerous budget goals.

Moriarty